BUDGET AND ECONOMIC REVIEW

BY THE COMMITTEE ON THE BUDGET, REPUBLICAN CAUCUS

B-71 Cannon House Office Building
Washington, DC 20515
Representative Paul Ryan, *Ranking Republican*

Phone: (202)-226-7270
Fax: (202)-226-7174
James T. Bates, *Republican Staff Director*

Volume 1, Number 1

12 July 2007

THE FARM BILL BUDGET – SUFFICIENT OR STARVED?

Summary

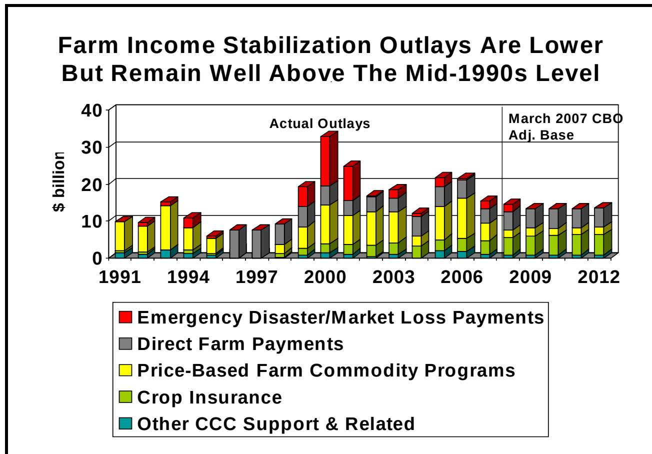
Government farm program advocates like to contend farmers have suffered a significant reduction in Federal support, and, as a result, billions of dollars are needed for this year's farm bill. The claim is pegged to the Congressional Budget Office's March 2007 baseline, which shows $60 billion less in commodity program spending (over 10 years) than estimates of 5 years ago; and it figures significantly in discussions of funding levels in the farm program reauthorization bill, scheduled for markup soon.

But the assertion of farm budget "cuts," if narrowly defensible, is highly misleading. The government's farm income stabilization spending – mainly farm commodity and crop insurance programs – is lower *because farmers' income from market sources is higher than previously estimated*, reducing the need for government support. Moreover, income stabilization spending remains relatively high due to the growth of crop insurance and non price-based direct payment programs. In addition, increased spending on food and nutrition programs – not considered in the "tight budget" scenario – also expands the entitlement baseline amount available to the Agriculture Committee, making it modestly larger than it was over the past 5 years.

The discussion below details the background of farm program funding, and helps explain the unusual nature of spending in these programs.

Background

Farm commodity programs are designed to shield producers of supported crops and milk from sharp fluctuations in market prices. Simply put, if market prices decline, government payments rise to help compensate – and vice versa. These programs, coupled with Federal crop insurance – which helps indemnify producers from weather-related production and revenue losses – form the core of the Federal farm income stabilization programs. Commodity programs, along with conservation, food stamps, and other 2002 farm bill programs, are up for re-authorization this year. Because of relatively high crop prices, projected demands on farm income stabilization programs have eased; and farm income has continued to be supported by direct farm payments and crop insurance, further discussed below. Nevertheless, income stabilization outlays are currently projected to cost $13 billion to $14 billion annually. In nominal terms, this is roughly double the outlays during the high-farm-price mid-1990s, which averaged about $6 billion to $7 billion (see chart above).



As with other Federal entitlements, the starting point for determining funding levels for farm bill programs starts with the "baseline" – in this case the March 2007 baseline by the Congressional Budget Office [CBO]. It shows the estimated costs of extending expiring farm programs as well as permanently authorized programs, such as crop insurance. In constructing this baseline, CBO assumes no changes in the underlying authorizing laws, but does take into account a variety of external factors that can affect the programs, such as the number of farmers projected to be covered by the programs, general economic conditions, estimated crop prices, and so on. When complete, the baseline identifies an amount of resources considered necessary for the

Agriculture Committee to renew the farm bill programs under current law.

Overall, this baseline – adjusted for the recently enacted 2007 supplemental appropriations – is $285 billion over the 5-year period of fiscal years 2008-12. All of this – except for about $2 billion in emergency-designated funding – is available to write the new farm bill. The $285 billion modestly exceeds the $271 billion in actual spending that occurred over the previous 5 years (fiscal years 2003-07), mainly because of continued expected growth in food and nutrition programs, particularly food stamps. Actual spending over the past 5 years was higher than the $249 billion that CBO projected in March 2002, including the estimated cost of that year's farm bill.

Recent history reflects how agriculture programs have been funded. Backed by extra spending provided in the fiscal year 2000 budget resolution, the Congress in June 2000 significantly expanded premium subsidies for crop and revenue insurance, and made other changes to encourage farmer participation. These steps were supposed to preclude the need for emergency farm disaster payments, which had become common following significant droughts and other adverse weather events. CBO estimated the legislation would raise crop insurance spending by $7 billion over the 2001-05 period.

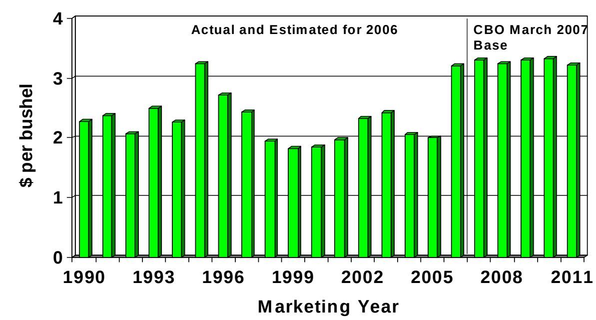
Two years later, the fiscal year 2002 budget resolution effectively provided an additional $73.5 billion over the 2002-11 period to support the 2002 farm bill – an increase of about 18 percent in the Agriculture Committee's overall mandatory spending baseline. Most of this amount – $57 billion – was used to increase farm commodity programs. "Direct" farm payments, which are not adjusted for market prices, were extended and increased; and this occurred even though these "transitional" payments originally were intended to be temporary under the 1996 farm bill. Production-inducing marketing loan rates were raised, and new counter-cyclical payment programs for supported crops, and a temporary program for milk, were added.

Most recently, the 2007 supplemental appropriations legislation provided an estimated $3.5 billion for emergency farm disaster payments for crops and livestock, and an additional $2.4 billion over 11 years (fiscal years 2007-17) to effectively create a permanent baseline for the milk counter-cyclical payment program. Other emergency farm disaster payment programs were provided earlier this decade, only one of which was partially offset.

The fiscal year 2008 budget resolution provides a $20-billion deficit-neutral reserve fund to support the writing of the new farm bill, but the fund can be tapped only if legislated offsets are found.

Despite the increases in recent years, it might be argued that the Agriculture Committee has a *reduced* budget available for the new farm bill. Under the CBO March 2007 baseline, farm commodity programs are projected to cost about $60 billion less over 10 years than the projection in 2002, when that year's farm bill was enacted; therefore, the "baseline" for funding these programs is $60 billion lower than it was then. Based on such an argument, one might conclude that billions of dollars in additional mandatory funding – above the baseline level – are needed to support conservation, energy, nutrition, and other farm bill programs.

Ethanol-Supported Corn Farm Prices Have Increased



But as noted at the outset, this unconventional argument is misleading. First, farm commodity programs have not been cut. CBO projects lower spending for price-based farm commodity programs because farmers' incomes are higher than previously expected. This is mainly because market prices are higher – and part of the price increase has resulted from Federal tax and other support for renewable fuels, such as corn-based ethanol (see chart above). As corn prices have risen, farmers have shifted more acreage into corn and away from other crops, reducing the supply of the latter. Hence farm prices are significantly higher not only for corn, but for many supported crops such as wheat and soybeans.

Last year, many crop producers who experienced normal or better crop yields, earned increased incomes. These income gains came mainly from the market, not from the Federal Government's farm subsidies. Assuming normal yields this year, many crop producers are expected to earn high incomes again.

All these factors reduce the estimated government cost of farm commodity programs.

The “tight budget” argument also ignores the crop insurance program, whose annual cost has more than doubled – from about $2 billion at the start of this decade to estimated $5 billion in fiscal year 2008. It fails to account, as well, for the ongoing cost of emergency farm disaster programs that are not assumed in baseline projections.

Conclusion

Unlike most other government spending, farm commodity programs – a major component of farm bill spending – are designed to respond to fluctuations in market prices. When market prices fall, government spending rises to compensate; when prices rise, the demand for government spending falls. In March this year, CBO projected market prices would be higher over the next 5 years than was estimated 5 years ago; and as a result, the estimated costs of commodity program are projected to be lower than they were then.

But this does not constitute a “cut” in farmers’ incomes. It simply means farmers are expected to earn more from market prices, and therefore need less in government support. In addition, it is misleading to view the commodity programs in isolation. This view ignores various other forms of farm spending – such as direct payments, crop insurance, and disaster assistance – that have increased significantly over the past decade. Taken together, the amount of funding available for the new farm bill appears to be consistent with the market conditions at hand.

Prepared by . . . . Andy Morton, Budget Analyst